WASHINGTON NOTES

FINANCING THE FIFTH LOAN

Secretary Glass on February 10 sent to Chairman Kitchin, of the Ways and Means Committee of the House of Representatives, a lengthy communication surveying the present financial situation of the government and transmitting a draft of a bill designed to provide the basis of the fifth Liberty Loan. The fundamental ideas in the bill are as follows: (1) increase of the authorized bonds from $20,000,000,000 to $25,000,000,000; (2) addition of power to issue $10,000,000,000 in short-term notes running from one to five years; (3) authority to the Secretary of the Treasury to fix the rate of interest upon both bonds and notes and to grant such tax exemptions both on new and upon the outstanding bonds as he might see fit; (4) authority to continue, after the peace treaty shall have been signed, the practice, already authorized for the war period, of making loans to foreign governments; (5) power for the War Finance Corporation to make loans in aid of foreign commerce. Secretary Glass's letter transmitting this legislation was followed by an oral statement before the House Ways and Means Committee on February 13, in which the purposes and methods of the proposed enactment were fully set forth. In general, the basis of the new financing will be a fifth Liberty or "Victory" Loan probably aggregating about $6,000,000,000 and sufficing chiefly to fund the certificates of indebtedness of ninety days' maturity which will then be outstanding in the banks. A small margin of the proceeds of the loan will doubtless be left after this funding process is completed, but it will not go far. Assuming that the loan is placed by the end of April or shortly thereafter, the Treasury will then open the month of May practically with the proceeds of the collections under the new War Revenue Act as its available resources, and for everything above these will turn to the banks through the medium of short-term notes sold on the market for par and supposedly transferred to individual investors and to institutions in such quantities as they are willing to take. As for the terms of the fifth loan itself, there is no intimation, but the request that power be given to bestow tax-exemption privileges upon the older issues of bonds implies—what is not evident on all hands—that the terms of the new loan will have to be considerably more favorable to the investor than those of the older issues. Whatever these terms may be, they will in a certain sense set the pace for the new basis to be assigned to the older issues, as well as

for the immediate sales of short-term notes which have been placed on the market in the way already described.

The turning-point in the war financing is thus found in the fifth loan, which is calculated to retire the old outstanding war paper and to provide a basis for driving it out of the banks and into the hands of investors, while a new epoch in Treasury finance is introduced by a transition effected through the use of the short-term notes. Needless to say, the success of this operation, gigantic and complex as it is, will depend very greatly upon the administrative measures that are taken under such legislation as Congress may grant. There seems to be little difference of opinion concerning the view that it will be wise to make the new issue bear an attractive rate of interest and to make it salable rather through concessions in the rate than through exemptions from taxation. One plan that has been suggested is that of offering two series of bonds, the one wholly exempt from taxation, the other entirely subject to it, and each convertible into the other at the will of the holder. Whatever may be done as to this, or the establishment of rates for the fifth bonds, or for the equalization of the return on the preceding issues with that yielded by the fifth loan, it will also be the part of prudence to make commitments only for a very short time in advance. That this phase of the situation is fully appreciated by those in charge of Treasury finance is seen in the circumstance that the maturities of the notes under the new legislation would vary from one to five years, thus leaving a very substantial degree of latitude within which the issue conditions may be successfully adapted to market requirements. As soon as possible after the financial effects of the war have disappeared, it will undoubtedly be wise to provide for the refunding and consolidation of the various issues of bonds and other obligations which are then still in the hands of investors.

WAR REVENUE ACT

Closely connected with the Treasury's announcement of its policy for the placing of the fifth Liberty Loan is the final action of Congress in passing the so-called War Revenue Bill. This measure was adopted by the House on February 10 and by the Senate on February 13. The President being absent in Europe, the measure could not be signed by him, but action was at once undertaken by the Treasury Department on the basis of the Conference Committee's draft, which was put before the two Houses on February 7 and acted upon as just indicated. The Conference Committee's draft is in many respects an entirely new bill,

the additions to the text of the older House and Senate measures contained in it being estimated at one-fifth to one-sixth of its entire content. Many of the changes made are of course technical only, but the measure also contains various alterations of principle intended, on the whole, to reduce the weight of the burden imposed by it on the business of the country. On the other hand effort is made throughout the measure to strike sharply at all enterprises which have succeeded in profiting by the war either as the result of government contracts or in other ways, but particularly as the outcome of public contracts taken and carried through at a profit.

Whatever may be thought of the terms of the bill in detail, its general purpose is the same as that which has been characteristic of the legislation from its very inception, now nearly a year ago. This is the imposition of rates of taxation sufficient to draw from the public, in the form of either individual or corporate returns, about the maximum contribution that can be exacted under present methods of collection. Assuming that the total yield of the bill will be about $6,000,000,000, as against the $8,000,000,000 or more originally sought for when the measure was first put forward during the summer of 1918, it will still remain the greatest measure of taxation in the financial history of the United States and probably in the history of the world.

Under the terms of the act the first returns are to be filed on March 15, and when filed are to be accompanied by a payment of one-fourth of the amount due, the remaining three-fourths to be payable at equal intervals or at any date during the payment period that may be preferred by the taxpayer. Thus the payment of the taxes under the new law and the process of subscribing to and taking up the new Liberty bonds run parallel with one another, being practically simultaneous. The first payment under the War Revenue Bill, on March 15, will precede the first payments of subscriptions under the Liberty Loan by probably four to five weeks at least, and it may be assumed that instalment payments on the loan will alternate with instalment payments on taxation. From those who both pay heavy taxes and subscribe to the Liberty Loan the spring and summer of 1919 will require continuous and heavy sacrifices, and the successful carrying through of both operations will be made practicable only by the extensive aid of the banks. Although there has been some reduction of the amount of war paper in the hands of banks during the past month or two, there can be no question that the opening of the fifth Liberty Loan period will find the banks still heavily burdened with "war paper" probably to an amount very much in excess of the

sums carried by them at the opening of previous Liberty loans. This renders it difficult to forecast the precise effect of the new tax and loan operations for the full extent to which the banks can safely go in sustaining them. It must be a good while before positive conclusions can be reached on these points, and the position of the banks will require careful watching from week to week while the operations in question are going on.

In the case of the tax measure the yield to be expected is likely to be smaller than the estimates, for the reason that war incomes have now been cut off and that, while the basis of taxation is of course the income obtained during the year 1918 when the war was still in progress, conditions surrounding the making of inventories and the writing off of losses at the close of the year 1918 were unfavorable to the full showing of profit that had been expected by Treasury statisticians. It is, moreover, to be expected that many concerns, finding themselves unable to meet their taxes out of current receipts, will be obliged to resort to the banks for the means with which to make their payments, and that these demands, if as large as they seem likely to be, will tend in some measure to cut off the ability of the banks to finance the sale of the new bonds. These are probably the chief problems to be considered in connection with the financing of the government during the next few months. As in all transition periods, they have a special importance to the business community in that the action of the government will in no small degree "set the pace" for the financial markets as a whole.

FEDERAL RESERVE BOARD'S ANNUAL REPORT

The fifth annual report of the Federal Reserve Board was sent to Congress on February 8. It constitutes a very much more lengthy review of the history of the Federal Reserve System than has been issued by the Board in any preceding annual report and supplies a historical account of the financing of the war from the banking standpoint that will be found nowhere else. The reports of the Secretary of the Treasury on war finance are necessarily concerned chiefly with Treasury conditions and only secondarily with the broader aspects of the banking and financial situation. What the Board shows in brief is that the history of the resources and lending power of the Federal Reserve System may be divided into two general periods, the first extending from the opening of the European war to the time when we ourselves became belligerents, the second extending to the close of the year 1918. During the second period the powers of the system were increased by two principal methods: the addition of new members who now number about one thousand

state institutions, and the compulsory transfer of the reserves of members to the Federal Reserve banks as the sole reserve-holding institutions. The fact that an embargo was established upon gold, and that as a result of this embargo the campaign for the voluntary transfer of gold coin to Federal Reserve banks was more successful than it could otherwise have been, is noted, and the report of the Board plainly implies that the embargo on gold has been of less value than had been expected, and that the technical advantage of increasing the stock of gold in the country has been far from what it was supposed by many to be. This is nowhere explicitly set forth in the report, but it is clearly a fair inference from the facts stated.

It is a natural consequence of the war that the portfolios of reserve banks have come to consist so largely of war paper, this in some cases amounting to 80 per cent of their total assets. On the other hand the enormous earnings of Federal Reserve banks during the year 1918, amounting in the aggregate to more than $55,000,000 and in the case of some banks running to more than 100 per cent of capital after depreciation and allowances had been written off in the most generous fashion and after all "back dividends" had been paid, are attributable entirely to fortuitous consequences of the war, resulting as it did in driving much "war paper" to reserve banks for discount and thus giving them a steady source of income entirely apart from any efforts of their own in connection with the development of new business. It is noted accordingly as in no way singular that our genuine commercial-paper development has been somewhat retarded, particularly as so large a part of our foreign trade has been financed through the issue of government paper put out for the purpose of providing funds with which to pay for the supplies and services required by the public treasury.

Especially interesting is the Board's discussion of the reasons why the development of the bankers' acceptance in foreign trade has not proceeded more rapidly. For about a year past it has been noted by students of the banking situation that English institutions were not only offering rates of interest on deposits originating abroad with which our own city banks could not at all compete, but that phenomenally low acceptance rates were being granted by them, with the result that they were succeeding in holding the sterling business which they had acquired before the war—dollar exchange being of course correspondingly retarded in its growth. This process, facilitated as it has been by our own loans to the Allies, has been perhaps one of the incidental costs of our participation in the war. As to this point, the Board of course

makes no commitment of opinion, although the facts in the situation are very clearly stated. The report closes with probably the most detailed and complete account of the Board's actual organization and operations, as well as of those of the several Reserve banks, that has yet been authentically given to the public.

INDEXES OF BUSINESS CONDITIONS

Under the auspices of the Federal Reserve Board there has been undertaken and is now approaching complete development a system of business barometers or indexes. Many efforts to develop such figures have been made in the past, and various more or less incomplete series are now carried on by business concerns or by profit-making enterprises whose function it is to supply data of this kind in the form of a regular "service." During the past year, moreover, scientific work has been in progress at Harvard University with a view to developing a complete set of business indexes scientifically worked out. The efforts of the Federal Reserve Board are being carried on with the assistance of the Reserve banks and have thus far resulted in developing the following series of data: (1) complete interest and discount rates at Federal Reserve banks and at leading member banks in the Federal Reserve cities and in the places where the branches of Federal Reserve banks are located; (2) complete figures designed to show transfers at banks which are members of clearing houses, these figures being intended to take the place of, or supersede, clearing-house statistics as a guide to business conditions; (3) wholesale prices classified to show producers' and consumers' goods, agricultural products, and other groups believed to be characteristic; (4) volume-of-production figures, intended to show changes in aggregate output in basic industries such as steel, cotton and woolen goods, leading manufactures, coal, and a considerable number of others; (5) transportation figures designed to show movement of goods in domestic and international trade. The indexes as thus gathered are to be published in the *Federal Reserve Bulletin*, but no effort is to be made to generalize from them with respect to the probable future of business and trade, such inferences being left to be drawn by those who find it convenient to make use of the data thus supplied in connection with their studies of industrial and other conditions. Enough progress is being made in collection of the data to assure a fairly complete statistical record of the progress of and variations in finance, production, and industry.